



California Debt and Investment Advisory Commission
Municipal Debt Essentials

The Changing Roles and Responsibilities of Debt Issuers and Finance Team Members

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Overview of City and Its Debt Portfolio

Overview

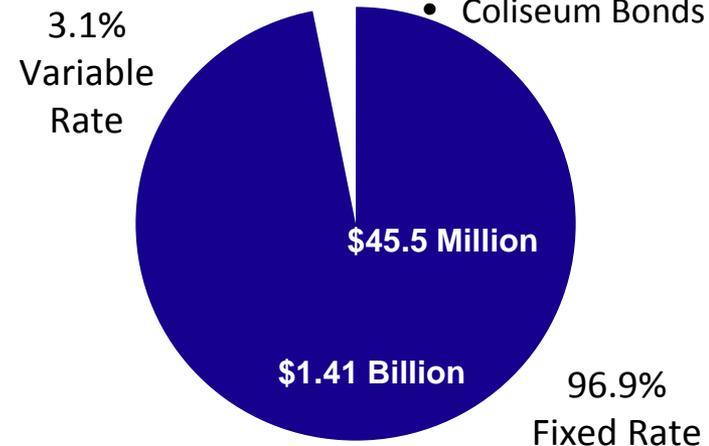
- 8th largest city in CA: Population¹: 399,326
- Port of Oakland, 5th busiest maritime port in US and 3rd largest container port on the U.S. West Coast
- Oakland International Airport ranked 13th for cargo traffic and 36th for passenger for traffic
- Heart of BART system sits in downtown Oakland
- Accessible to all other Bay Area cities
- Many new accolades
 - America's Most Exciting City
 - #5 Global Travel Destination in 2012
 - Greenest City in America

Debt Portfolio (\$1.5 billion)

	Tax-Exempt		Taxable	
City	\$	539,780,706	\$	458,919,000
ORSA ²	\$	155,755,000	\$	300,715,000
	\$	695,535,706	\$	759,634,000

Types of Bonds

- General Obligation Bonds
- Lease Revenue Bonds
- Special Assessments
- Pension Obligation Bonds
- Tax Allocation Bonds
- Coliseum Bonds



1. Source: California Department of Finance, as of May 1, 2013

2. Oakland Redevelopment Successor Agency

□ **General Considerations when choosing your finance team**

- ✓ Relevant experience to the proposed financing
- ✓ Key personnel assigned to serve the City
- ✓ Costs
- ✓ All hiring of consultant is through a competitive Request For Proposal (RFP)

General Considerations

Financial Advisor (FA)

- ✓ Majority of the time the City hires an FA (usually the 1st hired consultant)
- ✓ The City has a pool of FAs that we use for different financing needs

Underwriter

- ✓ Depending on the method of sale (Competitive vs. Negotiated)

Bond/Disclosure Counsel

- ✓ Works with City Attorney to hire Bond/Disclosure Counsel

The Role of a Financial Advisor in a Municipal Bond Transaction

David Brodsky, Managing Director

Key Roles of the Financial Advisor

- Protect the issuer's interest during the entire issuance process
- Evaluate financing options with issuer and develop a plan of finance
- Assist in selection of other team members
- Manage the schedule
- Review all necessary documents, including legal covenants and disclosure
- Structure and size debt service/review underwriter's numbers
- Help prepare and deliver rating agency presentations
- Recommend a method of sale. Conduct competitive sale or negotiate rates and spreads for negotiated bond sale
- Ensure closing and assist with post-closing compliance
- Assist in development of debt and finance policies
- Assist in staff training and development

Who is a Financial Advisor

- Role of the FA vs. the Underwriter
 - Some overlap in developing plan of finance, structuring the debt, reviewing documents, and ratings
 - Financial advisors do not underwrite (purchase from the issuer for resale to investors) bonds
 - The FA is a fiduciary, the underwriter is not, but is responsible for “fair dealing”.
 - Paraphrasing a recent underwriter disclosure: “The primary role of the underwriter is to purchase securities, for resale to investors, in an arm’s-length commercial transaction between the issuer and the underwriter. The underwriter has financial and other interests that differ from those of the issuer. The underwriter is not acting as a municipal advisor, financial advisor or fiduciary .”
- When Do You Hire a Financial Advisor?
 - When you don’t know whether you want to sell bonds at competitive or negotiated sale
 - When you know you want to sell bonds at a competitive sale
 - When you want an independent voice in the process of a negotiated sale
 - When you want a general advisor that transcends a given transaction
 - Financial advisors are not just for “unsophisticated” and “infrequent” issuers: Large, frequent issuers tend to use financial advisors on all of their transactions
- Types of firms
 - Usually independent consulting firms
 - Range from one-person shops to national firms with multiple offices
 - Occasionally investment bankers wearing another hat

Financial Advisors after Dodd-Frank

- The Dodd-Frank Act of 2009 codifies the *fiduciary* obligation of Financial Advisors
 - Requires that FA puts their clients' interests first, without regard to their own financial or other interests
 - Formalizes substantive distinction in roles and duties between advisors and broker-dealers
 - Puts focus squarely on real and potential “conflicts of interest” between advisors and municipal clients
- SEC recently defined a “municipal advisor”
 - Awaiting rules from MSRB on what a municipal advisor is specifically supposed to do
- Prior proposed MSRB rules offer a hint towards the future
 - Duty of Loyalty
 - Emphasizes written disclosure and informed consent regime regarding conflict of interest
 - Introduces concept of “unmanageable conflicts” for kick-backs, fee splitting, finders fees, etc.
 - Duty of Care
 - Necessary qualifications
 - Consideration of alternatives
 - Duty of inquiry

The Role of an Underwriter in a Municipal Bond Transaction

Backstrom McCarley Berry & Co., LLC

Selection of Underwriter

- Competitive Sale
 - Lowest bid determines underwriter and the sale of the bonds
 - Issuer has limited contact with potential underwriters prior to the sale of the bonds
- Negotiated Sale
 - Typically selected through a public solicitation for proposals evaluating some or all of the following:
 - Experience
 - Strength of salesforce and marketing
 - Innovative ideas and contribution to financing
 - Fees

Responsibilities and Timeline

- Develop plan of finance
 - Financial modeling and sensitivity analysis
 - Debt service capacity analysis
 - Legal and financing documentation drafting
- Structuring
 - Credit presentation
 - Finalize documentation
 - Informational meetings for staff and governing board
- Marketing and Sale
 - Marketing update calls as needed
 - Investor presentations as needed
 - Pre-pricing feedback and sale of the bonds (execution of bond purchase contract)
 - Financial close of the financing

Underwriter Compensation

- Compensation contingent on the successful closing of the bonds
 - Takedown: Per bond compensation typically tied to the difficulty in the sale of the bonds
 - Expenses: Inclusive of underwriter's counsel, DTC, IPREO and clearing fees
 - Management Fee: Less typical compensation for the investment banking effort related to the sale of the bonds

THE ROLES OF BOND COUNSEL and DISCLOSURE COUNSEL

Michelle Sexton, Partner, Rosales Law Partners LLP

THE ROLE OF BOND COUNSEL

- Over the years, Bond Counsel came to be hired by the issuer rather than the bankers. The role of Bond Counsel now includes legal advice to the issuer throughout the authorization and sale of the bonds.
- The second role of Bond Counsel is to advise and opine that the bonds bear tax-exempt interest under Federal law. This was a simple task from 1913, when the first income tax was enacted, until 1968. In that year, the Federal tax law was amended to deny tax-exempt status to municipal bonds that financed “private use” facilities. In 1969, the tax law was amended again to deny tax-exempt status for “arbitrage” bonds, i.e. bonds issued at low tax-exempt rates where the proceeds are invested in higher yielding taxable investments. These two issues – use of proceeds and investment of proceeds – generate many difficult tax issues.
- Bond Counsel must sort out these complex issues to opine that the bonds of a particular issue will bear tax-exempt interest.

THE ROLE OF BOND COUNSEL

- The third role of Bond Counsel is to advise the issuer as to compliance with Federal Securities Laws. While municipal bonds are not subject to SEC registration, issuers must comply with SEC requirements to provide truthful and adequate disclosure when bonds are first issued (primary disclosure) and to file continuing disclosure annually as long as the bonds remain outstanding (secondary market disclosure). There are exceptions to this broad statement of disclosure requirements and Bond Counsel must advise its clients on compliance with these rules

THE ROLE OF BOND COUNSEL

- Bond Counsel must be conversant with these three aspects of the law of Public Finance: validity, tax exemption and compliance with securities laws. Familiarity with these aspects of the law of Public Finance is only the basic level one should seek when selecting Bond Counsel. Experience, competence, responsiveness and creativity are necessary attributes to look for when considering who should be selected as Bond Counsel. These characteristics are essential if Bond Counsel is to represent issuers in a cost-effective, efficient manner and to solve the difficult problems that frequently arise.

THE ROLE OF BOND COUNSEL

- ❑ drafts bond resolution, indenture, loan agreement and/or other bond financing documents
- ❑ reviews applicable law to confirm the issuer's authority to issue the bonds and its conformity with other legal requirements
- ❑ affirms issuer's authorization of the bond offering
- ❑ discloses and examines litigation that may jeopardize the validity of the bond issue
- ❑ interprets arbitrage regulations and tax law
- ❑ attests to the validity and enforceability of the bonds
- ❑ provides guidance in structuring issues related to tax law
- ❑ confirms tax-exempt status
- ❑ drafts tax certificate

DISCLOSURE COUNSEL

- Prepares the official statement disclosing all information pertinent to a potential bond investor
- Drafts the necessary SEC 10(b)(5) antifraud opinion
- Reviews all documentation prepared by the issuer, bond counsel, underwriter and financial advisor
- Reviews and reports on all applicable law
- Participates in informational meetings with ratepayers, developers, and other such project stakeholders
- Ensures that all IRS, SEC, MSRB and other such regulatory agency requirements are met